RATING REPORT

Telenor Microfinance Bank Limited (TMB)

REPORT DATE:
May 8, 2019

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A+	A-1	A+	A-1
Rating Date	*April 30' 19*		*April 27,'18*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 2005	**External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants (2018)
Public Limited Company	**Chairman:** Petter-Børre Furberg
Key Shareholder(s):	**Acting Chief Executive Officer:** Muhammad Aslam Hayat
Telenor Pakistan B.V (Telenor Group) – 66.32%	
Alipay (Hong Kong) Holding Limited (Ant Financial) – 33.68%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria : Microfinance Institutions - May 2016
http://www.vis.com.pk/docs/Meth-MFBs201606.pdf

Telenor Microfinance Bank Limited (TMB)

OVERVIEW OF THE INSTITUTION

Telenor Microfinance Bank Limited (TMB) was incorporated in 2005 as a limited company under the Companies Ordinance, 1984.

Profile of Chairman

Petter-Børre Furberg carries over ~20 years of experience in the field of telecommunication and information technology. He has been associated with Telenor Group since 1998 and he has held a number of executive positions, He has served as Executive Vice President of Emerging Asia Cluster at Telenor ASA since May 30, 2017. Enhancing his role in the global market, he served as Chief Executive Telenor Myanmar from July 2013 to August 2016.

Profile of Acting CEO

Muhammad Aslam Hayat carries over ~30 years of professional experience. Before joining Telenor, he worked as the Center Director of Pacific ICT Regulatory Resource Centre (PIRRC) based in Fiji, a jointly funded project of World Bank and Asian Development Bank. He also worked at Grameenphone (a Telenor subsidiary) for five years.

RATING RATIONALE

Telenor Microfinance Bank Limited (TMB) is a subsidiary of Telenor Pakistan B.V (TP), (a Netherland based company owned by Telenor ASA) having major shareholding in the bank. In accordance with strategic partnership agreement with Ant Financial (AF) in Pakistan of investing US$ 184.5m for 45% stake in TMB, Alipay (Hong Kong) Holding Limited had acquired 33.68% of shareholding in the bank as at end-December'2018. As per the initially envisaged agreement, remaining equity injection of US$ 70.0m will be completed in 2020.

Originated from Alipay and officially established in 2014, AF is a technology company focused on providing digital payment solutions for small and micro enterprises, as well as individuals. Brands under AF include Alipay, Ant Fortune, Zhima Credit and MYbank. Alipay is the world's leading online and mobile payments platform with over 1billion users. The objective of this strategic partnership is to further develop and make value additions in TMB's mobile payment and digital financial services.

As on December 31, 2018, TMB's operations were spread across 104 branches (2017: 83 branches) nationwide. Accounting for financial centers, TMB's footprint extends across 177 locations. Commencing operations in 2005, the bank has a proven track record in microfinance segment with advances portfolio base of Rs. 34.2b and remains the second largest microcredit provider with a market share of 12.4% in terms of gross advances. On the branchless banking (BB) front, TMB operates under the brand name "Easy Paisa" and is the market leader in terms of number of total and active accounts.

In line with strategic partnership agreement, TMB's key strategic focus over the medium term remains on aggressive customer acquisition (both in mobile account and mobile application platform) and encourage high frequency and mass appeal transactions. This will facilitate TMB to develop an ecosystem for customers to manage their financial and telecom related needs. Customer acquisition witnessed noticeable growth during 2018 with healthy growth expected to continue in the ongoing year given aggressive marketing spending planned. Management is pursuing a telco-agnostic approach to achieve growth in customers and has recently partnered with a telecom operator to provide direct and seamless integration between the two platforms. Similar agreements are also expected with other telecom operators in the ongoing year. As per management, user friendly app and in-house app development capability to cater to changing user needs will be key factors supporting customer growth and will provide TMB a competitive edge over competitors.

Key Rating Drivers:

Strong sponsor profile and demonstrated support is a key rating driver.
The assigned ratings reflect robust financial profile of both sponsors, TP and AF. TP is a Netherland based company and a wholly owned subsidiary of Telenor Norway. Telenor Group has a credit rating of "A/A-1" (Single A/ A-One) on the international scale from S&P. AF is a China based company and is owned by the Alibaba Group. Alibaba Group Holding Limited has a credit rating of "A1 Stable" on the international scale by Moody's Investors Service. Shareholding of AF is expected to increase further to 45% in 2020 with remaining equity injection.

Loan portfolio continued growth momentum although asset quality indicators have weakened due to certain internal control issues which later have been addressed. Controlled portfolio growth along

with further strengthening in controls will be key focus areas in 2019.

During the outgoing year, gross advances portfolio registered increase of 36.7% vis-à-vis the preceding year. Number of active clients increased by 22.4% in 2018. Growth in loan portfolio was a function of expansion in branch network, increase in loan officers and increase in average loan size. Overall product-wise portfolio remains diversified (Karobar, Livestock, Agriculture, Livestock and Gold) with secured portfolio representing around one-fifth of financing portfolio. Gross advances portfolio includes a mix of bullet and EMI loans while group loans comprise over one-tenth of the overall advances. Besides growth in existing products, lending activities will be geared towards large ticket microenterprise loans and digital lending.

Asset quality indicators have weakened on a timeline basis with gross and net infection increasing to 4.1% (2017: 1.0%) and 2.5% (2017: 0.8%) respectively. Asset quality was affected due to certain internal control issues which later have been addressed. Subsequently, management has taken a number of steps to enhance controls. In view of ongoing efforts, infection levels are projected to witness improvement over the ongoing year.

Liquidity profile remains manageable due to presence of sizeable liquid assets in relation to deposits and borrowings although depositor concentration and deposit mix has depicted weakening. Management expects ongoing customer acquisition to result in sizeable growth in current account deposits from BB operations over the next two years.

With growth in liquid assets outpacing rise in deposits, liquid assets in relation to total deposits and borrowings depicted improvement in the outgoing year. However, concentration in deposits continued to increase in 2018. Nevertheless, overall liquidity profile remains manageable due to presence of sizeable liquid assets in relation to deposits and borrowings. Proportion of current accounts and CASA ratio depicted some decline in the outgoing year although the same is expected to improve over the rating horizon with envisaged growth in BB customers.

TMB incurred a loss in 2018 on account of sizeable marketing expense and increase in provisioning charges. Profitability profile is expected to improve over the medium term given that aggressive customer acquisition drive is projected to continue.

Growth was witnessed in TMB's topline on the back of growth in advances portfolio. However, the bank posted a net loss in 2018 on account of increase in provisions and expenses incurred for BB customer acquisition. As per management, acquisition cost per customer is on the lower side vis-à-vis other similar global benchmarks. Given that growth in expenses outweighed the growth in recurring income of the bank, operational self-sufficiency ratio decreased to 95.7% (2017: 107.2%). Going forward, profitability of branch banking segment is projected to be a function of volumetric growth in advances and recoveries. On the other hand, BB segment may witness increase in income on the back of higher quantum of transactions. However, management expects expenses to rise significantly as well because aggressive growth in active customers remains the key strategic focus of the bank. VIS will also track impact of competitive pressures on projected profitability indicators over the long-term.

Despite projected losses, capitalization indicators are projected to be supported by cushion available above the minimum regulatory requirement and further equity injection by AF. A documented funding and capitalization plan is in place with overall equity injection being higher vis-à-vis expected losses.

Total equity has increased to 13.7b (2017: Rs. 5.0b) on the back of equity injection in 2018. As a result, despite growth in unsecured portfolio and losses incurred, capital adequacy ratio (CAR) of the bank increased notably to 35% (2017: 19%). CAR stands at a comfortable level, above the minimum regulatory requirement of 15% depicting room for growth.

FINANCIAL SUMMARY		*(amounts in PKR millions)*
BALANCE SHEET	**2017**	**2018**
Total Investments	6,767	9,008
Net Advances	24,762	32,945
Cash and Bank Balances	7,808	8,075
Total Assets	47,488	62,466
Deposits and other accounts	36,665	42,275
Borrowings	-	-
Equity (excluding surplus)	5,007	13,671
Capital Adequacy Ratio	19%	35%
INCOME STATEMENT	**2017**	**2018**
Net Mark-up Income	4,297	6,126
Net Provisioning / (Reversal)	242	1,387
Non-Markup Income	8,488	8,387
Administrative Expenses	11,812	14,948
Profit/ (loss) after tax	417	(2,516)
RATIO ANALYSIS	**2017**	**2018**
Current Accounts (CA) (%)	39.2%	26.1%
Current & Saving Accounts (CASA) (%)	50.6%	48.8%
Gross Infection (%)	1.0%	4.1%
Net Infection (%)	0.8%	2.5%
Net NPLs to Equity (excluding surplus) (%)	3.8%	5.8%
Total Provisioning Coverage (%)	93.8%	88.6%
Advances to Deposits (%)	68%	81%
Return on markup bearing assets (%)	16.0%	16.7%
Cost of Funds (Deposits) (%)	5.3%	5.7%
Markup Spreads (%)	10.7%	11.0%
Operational Self Sufficiency (%)	107.2%	95.7%
Return on Average Assets (%)	1.0%	-4.6%
Liquid Assets to deposits & borrowings (%)	48.9%	53.4%

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Telenor Microfinance Bank Limited (TMB)
Sector	Micro Finance Bank (MFB)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Rating Outlook	Short Term	Rating Action
RATING TYPE: Entity				
4/30/2019	A+	Stable	A-1	Reaffirmed
4/27/2018	A+	Rating Watch-Developing	A-1	Maintained
4/28/2017	A+	Stable	A-1	Reaffirmed
4/28/2016	A+	Stable	A-1	Reaffirmed
4/17/2015	A+	Stable	A-1	Reaffirmed
4/23/2014	A+	Stable	A-1	Upgrade
3/27/2013	A	Stable	A-1	Reaffirmed
12/26/2012	A	Stable	A-1	Reaffirmed

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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